

# Bob Brinker's **Marketimer**

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"The discount on the future is in the process of becoming far greater than it has been in many decades."

... Peter L. Bernstein

## STOCK MARKET TIMING

DJIA: 7591.58

S & P 500: 815.26

Our current forecast for Real Gross Domestic Product growth for calendar year 2002 falls within a range of 2% to 2.5%. Our preliminary forecast for calendar year 2003 is within a range of 2.25% to 2.75%. Within this forecast, we are staying with our current estimates for Standard and Poor's 500 Index operating earnings of \$42.20 for 2002 and \$47.10 for 2003. These estimates remain well below consensus Wall Street projections. Our GAAP estimates for 2002 and 2003 remain at \$37.20 and \$42.10 respectively. GAAP earnings include all charges, except those from discontinued operations and some extraordinary items.

Based on our projected calendar year 2002 operating earnings estimate of \$42.20, the Standard and Poor's 500 Index traded at 19 times earnings when it recorded its cyclical bear market closing low-to-date of 797.70 on July 23. As the October issue of **Marketimer** goes to press, the Standard and Poor's 500 Index stands at 815.26. This brings the current price/earnings ratio, based on our 2002 operating earnings estimate, to 19.3. If we are correct, and double-digit percentage earnings gains materialize next year, the price/earnings ratio based on our 2003 estimate is 17.3.

Price/earnings ratios can vary greatly depending on many factors. Investors weigh a myriad of inputs in the p/e ratio equation. These include inflation expectations, interest rates, the quality of earnings, earnings growth rates, and the visibility of earnings growth. Using inflation as a guideline, when inflation is very low as it is now, the average p/e ratio on the Standard and Poor's 500 Index has been 18 times earnings during the past half-century. In our view, a case can be made for p/e ratios to fall within a range of 18 to 20 times earnings, as long as inflation remains very low and interest rates stay down. We remain optimistic about the outlook for low inflation given our moderate economic expectations into next year. Interest rates are also likely to remain benign until we see the development of sustainable upside economic momentum.

Federal Reserve monetary accommodation remains a critical ingredient for future economic growth in an economy that continues to experience tepid final demand. Factory activity remains weak as evidenced by the poor showing in the ISM manufacturing index during the third quarter, with new orders showing particular weakness. Net exports have been disappointing as global economies continue to struggle.

The U.S. economy continues to labor under the weight of the negative wealth effect caused by a very long and deep cyclical bear market. Efforts to stimulate final demand through a combination of income tax cuts and aggressive monetary ease have prevented an even steeper economic decline, but have so far failed to ignite a sustainable economic recovery. One clear sign of economic recovery would be an average monthly jobs growth figure approaching the 150,000 level. However, so far this year jobs growth has been anemic and unimpressive.

## STOCK MARKET TIMING (continued from page 1)

However, this is not the time to be overly pessimistic about the conditions that have contributed to this very long and deep cyclical bear market. Although the bear market has been extraordinarily painful for stock market investors, the reality is that cyclical bear markets do not last forever. We are now in the 31st month of one of the worst cyclical bears since the 1930's. Although it is true that we believe a secular bear megatrend commenced during the first quarter of Year 2000, it is also true that we have always expected cyclical bull market opportunities to occur within the broader megatrend. For this reason, we expect the next cyclical bull market to have an approximate length of one-to-three years, and to result in Standard and Poor's 500 Index gains of greater than 25%, and potentially much greater than 25%, if fundamental conditions improve sufficiently.

The average percentage gain, as measured by the Dow Jones Industrial Average, for the cyclical bull markets that occurred during the 1966-1982 secular bear market, was 52.4%. Each of these cyclical bulls was preceded by a cyclical bear market decline in excess of 25%. We consider the cyclical bulls that occurred during this period as particularly significant, because they developed during the frustrating sixteen-year secular bear market that saw the DJIA decline from 995 to 777, as the Standard and Poor's 500 Index moved essentially sideways, excluding cash dividends. Clearly, this extended period was extremely challenging for those trying to build their wealth in the stock market. However, the cyclical bull markets provided excellent money-making opportunities for successful market timing based investment strategies.

We will continue to monitor our long-term stock market timing model indicators closely going forward. When they return to bullish territory, as we are certain they will, we will issue a **Marketimer** buy signal, recommending reinvestment of all stock market cash reserves. While it is true that stock market valuations remain well above those that prevailed at most prior cyclical bear market bottoms, it is also true that an intervening cyclical bull market is likely to be followed by another cyclical bear market. At that time, the process of reducing overall stock market valuation levels, as part of the secular bear megatrend, is likely to continue.

We recommend continuing to hold stock market cash reserves at this time. We also recommend retaining existing stock market holdings, as we do not view the current period as a propitious time to be a seller of equities. On the contrary, we think there is a high probability that a **Marketimer** buy signal will develop within the next several months. Subscribers should visit [www.bobbrinker.com](http://www.bobbrinker.com) to check the bulletin page on a regular basis during the fourth quarter. Any major change, including a buy signal to return stock market cash reserves to the market, will be posted there for subscriber access if the change occurs between monthly newsletters. When our next buy signal occurs, we will post our specific model portfolio recommendations for model portfolios one, two, three and active/passive as part of the bulletin at the website. The information will also be mailed in hard copy form to all subscribers.

## FEDERAL RESERVE UPDATE

The Federal Open Market Committee decided to leave short-term interest rates unchanged at the September 24 meeting. As a result, both the federal funds rate and the discount rate remain at 40-year lows of 1.75% and 1.25% respectively. However, adjusted for the consumer price index over the past year, both the federal funds rate and the discount rate are in slightly negative territory in real terms.

As expected, the FOMC did not change the current bias toward economic weakness. Along with some positive comments regarding monetary policy and productivity growth, the Fed observed that "considerable uncertainty persists about the extent and timing of the expected pickup in production and employment, owing in part to the emergence of heightened geopolitical risks."

The Federal Reserve continues to do all they can to provide liquidity to the increasingly strained financial system. However, they cannot force corporate chieftains to make decisions to build factories, purchase equipment, and hire workers when the outlook for sustainable growth in final demand remains cloudy. Also, corporate bigwigs are well aware that pricing power is absent in this economy. This raises the risk that expanding business plans may be less prudent than simply preserving corporate assets.

Although M-1 continues to show anemic growth, the other monetary data suggests that the Fed's accommodative monetary policy is doing some good. The monetary base shows real year-over-year growth of 7.2% versus 7.6% last month. M-1, which consists primarily of currency in circulation and demand deposits, is up only 1.7% in real terms year-over-year, down from 2.1% last month. The broader M-2 monetary aggregate now shows real year-over-year growth of 5.4%, down from 6% last month.

**Table A**  
Latest Monthly Data  
(Billions)

	<u>September 2002</u>	<u>September 2001</u>	<u>Y-O-Y</u> <u>Changes</u>	<u>Real Y-O-Y*</u> <u>Changes</u>
Monetary Base	\$ 688	\$ 631	+ 9.0%	+ 7.2%
M-1	\$ 1,179	\$ 1,139.4	+ 3.5%	+ 1.7%
M-2	\$ 5,700	\$ 5,315.5	+ 7.2%	+ 5.4%

\* Real changes year-over-year, adjusted for consumer price index increase of 1.8% for the 12-month period through 8-31-02.

#### BETA COEFFICIENT UPDATE

The beta coefficient of an investment portfolio, mutual fund or stock is a measure of the market risk present in the investment. The beta is the covariance of a portfolio, fund or stock in relation to the rest of the market. The Standard and Poor's 500 Index has a beta coefficient of 1.00. A higher beta suggests greater volatility than the Standard and Poor's 500 Index, while a lower beta suggests less volatility.

A conservative investor seeking preservation of capital should focus on lower aggregate betas, whereas an aggressive investor who is young and seeks high potential reward and is willing to accept high risk can accept higher betas. This month we are updating our beta readings for each of the funds on the **Marketimer** Recommended List.

#### Beta Coefficient Table

Baron Growth Fund	1.00	Vanguard Index 500	1.00
Baron Small Cap Fund	1.05	Vanguard Extended Index	1.20
Gabelli Asset Fund	0.74	Vanguard Small Cap Index	0.80
TIAA/CREF Equity Index	1.02	Vanguard Total Market Index	1.02
TIAA/CREF Growth & Inc.	1.02	Vanguard International Growth	0.70
Dodge & Cox Stock Fund	0.60	T. Rowe Price European	0.69
Dodge & Cox Balanced	0.38	Longleaf Partner's Int'l.	0.35
Vanguard Calvert Social	1.02 est.	Rydex OTC Fund	2.28
Schwab 1000 Index	1.00	Vanguard Prime Money Market	0.00

You can construct your weighted average portfolio beta by multiplying the dollar amount of each of your equity positions by the beta coefficient, then dividing the sum of the totals by the total market value of your portfolio. This will provide you with a guideline for your relative expected volatility versus the overall equity market as measured by the Standard and Poor's 500 Index.

**BOB BRINKER'S RECOMMENDED LIST OF NO-LOAD FUNDS**

<u>FUND</u>	<u>INV.*</u>	<u>SIZE</u>	<u>% Total Return</u>						<u>\$1000 INV.</u>	<u>EST.<sup>a</sup></u>	<u>TEL.</u>	<u>ANN.<sup>b</sup></u>	<u>PRICE</u>
	<u>OBJ.</u>	<u>MIL.\$</u>	<u>'97</u>	<u>'98</u>	<u>'99</u>	<u>'00</u>	<u>'01</u>	<u>'02</u> (9-30)					
Baron Growth Fund 767 Fifth Avenue 49 <sup>th</sup> Floor New York, NY 10153 800-992-2766	G BGRFX	\$ 931	31.1	0.1	44.7	(4.6)	12.7	(12.1)	\$ 1795	0.0%	#	1.40%	26.96
Baron Small Cap Fund 767 Fifth Avenue 49 <sup>th</sup> Floor New York, NY 10153 800-992-2766	CGA BSCFX	\$ 723	-	2.2	70.8	(17.5)	5.2	(9.7)	---	0.0%	#	1.39%	13.73
Gabelli Asset Fund One Corporate Center Rye, NY 10580 800-422-3554	G GABAX	\$ 1566	38.1	15.9	28.5	(2.4)	0.2	(21.0)	\$ 1589	0.0%	Yes	1.37%	26.04
TIAA/CREF Equity Index 730 Third Avenue New York, NY 10017 800-223-1200	Russell 3000 TCEIX	\$ 121	-	-	-	-	(11.6)	(27.2)	---	1.0%	Yes	0.26%	5.86
TIAA/CREF Growth&Income 730 Third Avenue New York, NY 10017 800-223-1200	G&I TIGIX	\$ 468	-	30.5	24.5	(7.3)	(13.4)	(29.0)	---	1.0%	Yes	0.43%	8.50

\* Investment Objective Codes: CGA = Capital Gains Aggressive; G = Growth; G&I = Growth & Income

a) Estimated annual yield represents approximate investment income for last 12-months expressed as percentage of fund assets.

b) Annual expense ratio reflects investment advisory fees and other expenses expressed as percentage of total fund assets.

# Telephone redemption available.

BOB BRINKER'S RECOMMENDED LIST OF NO-LOAD FUNDS

FUND	INV. OBJ.	SIZE MIL.\$	% Total Return						\$1000 INV. 1-1-97=	EST. <sup>a</sup> YD.	TEL. SWCH	ANN. <sup>b</sup> EXP.	PRICE 09-30-02
			'97	'98	'99	'00	'01	'02 (9-30)					
Dodge & Cox Stock 1 Sansome St. (35th Fl.) San Francisco, CA 94104 800-621-3979	G&I DODGX	\$ 11437	28.4	5.4	20.2	16.3	9.3	(17.1)	\$ 1714	1.7%	#	0.55%	82.19
Dodge & Cox Balanced 1 Sansome St. (35th Fl.) San Francisco, CA 94104 800-621-3979	G&I DODBX	\$ 6628	21.2	6.7	12.0	15.1	10.0	(8.5)	\$ 1678	3.1%	#	0.53%	58.32
Vanguard Calvert Social Index Fund P.O. Box 2600 Valley Forge, Pa 19482 800-662-2739	Social Index VCSIX	\$ 87	---	---	---	(9.0)	(14.1)	(31.3)	---	0.8%	Yes	0.25%	5.33
Schwab 1000 (R) 101 Montgomery St. San Francisco, CA 94101 800-266-5623	G SNXFX	\$ 3154	31.9	27.1	21.0	(8.2)	(12.3)	(26.9)	\$ 1194	1.1%	Yes	0.46%	23.34
Vanguard Index 500 P.O. Box 2600 Valley Forge, Pa 19482 800-662-2739	S&P 500 VFINX	\$ 53520	33.2	28.6	21.1	(9.1)	(12.0)	(28.0)	\$ 1195	1.5%	No	0.18%	75.26

R) 0.50% redemption fee on shares held less than six months.

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BOB BRINKER'S RECOMMENDED LIST OF NO-LOAD FUNDS

FUND	INV.*	SIZE	% Total Return						\$1000 INV. 1-1-97=	EST. <sup>a</sup> YD.	TEL. SWCH	ANN. <sup>b</sup> EXP.	PRICE 9-30-02
	OBJ.	MIL.\$	'97	'98	'99	'00	'01	'02 (9-30)					
Vanguard Index (x) Extended Market Portfolio P.O. Box 2600 Valley Forge, Pa 19482 800-662-2739	Index VEXMX	\$ 2471	26.7	8.3	36.2	(15.5)	(9.2)	(22.6)	\$ 1110	1.1%	No	0.25%	17.88
Vanguard Index (x) Small Cap Stock Portfolio (address/phone above)	Russell 2000 NAESX	\$ 2810	24.6	(2.6)	23.1	(2.7)	3.1	(24.6)	\$ 1130	1.4%	No	0.24%	14.94
Vanguard Index Total Stock Market Portfolio (address/phone above)	Wilshire 5000 VTSMX	\$ 13048	31.0	23.3	23.8	(10.6)	(11.0)	(26.6)	\$ 1168	1.4%	No	0.20%	18.70
Vanguard International Growth Portfolio (address/phone above)	Non USA VWIGX	\$ 4318	4.1	16.9	26.3	(8.6)	(18.9)	(23.9)	\$ 867	1.8%	Yes	0.52%	11.42
Rowe Price European 100 East Pratt St. Baltimore, MD 21202 800-638-5660	Europe PRESX	\$ 603	17.0	25.8	19.7	(6.7)	(20.7)	(26.8)	\$ 954	2.7%	Yes	1.01%	11.72
Longleaf Partner's Int'l 6410 Poplar Ave. Suite 900 Memphis, TN 38119 800-445-9469	Int'l Growth LLINX	\$ 877	---	---	24.4	25.9	10.5	(21.2)	---	1.1%	#	1.79%	9.73
Rydex OTC Fund 6116 Executive Blvd. Suite 400 Bethesda, MD 20852 800-820-0888	CGA RYOCX	\$ 433	21.9	86.5	100.6	(37.8)	(34.7)	(47.7)	\$ 969	0.0%	Yes	1.15%	5.78

x) Vanguard Index Extended and Small Cap funds charge purchase fees of 0.5% or less to defray expenses of broad diversification;  
annual expense ratios on these funds are extraordinarily low.

#) telephone redemption available

## MODEL PORTFOLIO III CHANGE

In the **Marketimer** balanced Model Portfolio III, the following change is effective on Tuesday, October 8th:

SELL: 25% Vanguard Short-Term Federal (VSGBX), thereby eliminating the position;

BUY: 25% Vanguard Inflation-Protected Securities (VIPSX), establishing position.

## INTEREST RATES / FIXED-INCOME SECURITIES

We are changing the composition of our **Marketimer** fixed-income recommendations this month by eliminating Vanguard Fixed-Income Short-Term Federal (VSGBX), and adding Vanguard Inflation-Protected Securities. As a result of this change, the current average yield on this portfolio is 4.37%, plus the quarterly inflation adjustment on Vanguard Inflation-Protected Securities. The average maturity is 6.9 years, and the average duration is 3.15.

Duration is the weighted average of the times that interest payments and the final return of principle are received. The academic rule of thumb is that the percentage change in the price of a bond or bond fund is the duration multiplied by the interest rate change. Applying duration to the Vanguard Ginnie Mae Fund, the fund's current duration of 2.3 suggests that a one percent increase in corresponding interest rates would produce an estimated 2.3% decline in the fund's net asset value.

<u>Fund</u>	<u>Weighting</u>	<u>Yield</u>	<u>Avg. Mat.</u>	<u>Duration</u>
Vanguard Inflation-Protected Securities (VIPSX)	25%	2.09%*	13.1	4.0
Vanguard Ginnie Mae Fund (800-662-7447) (VFIIX)	50%	4.87%	3.1	2.3
Dodge & Cox Income Fund (800-621-3979) (DODIX)	25%	5.64%	8.2	4.0

- \* Vanguard Inflation-Protected Securities Fund has a current yield of 2.09% plus inflation adjustments based on the consumer price index. All distributions in this fund are paid in one distribution at the end of each quarter. On September 26, the third quarter distribution consisted of \$0.10 per share. Of this amount, \$0.067 was interest for the third quarter, and \$0.033 was the quarterly inflation adjustment. (The next auction of 10-year Treasury TIPS will be on October 9.)

Our favorite money market funds are Vanguard Prime Money Market, yielding 1.51%, and Vanguard Tax-Exempt Money Market, yielding 1.45%. For tax-exempt investment income, we like state general obligation municipal bonds in the 10-to-12 year maturity range.

## INDIVIDUAL ISSUES

The following issues are rated hold at this time. Exposure to any one company stock should not exceed 4% of equities in order to control specific stock risk.

<u>ISSUES</u>	<u>Beta</u>	<u>Exchange</u>	<u>Symbol</u>	<u>9-30 Close</u>	<u>Est. earnings per share</u>	
Microsoft	1.27	Nasdaq	MSFT	43.69	1.90 (6-03)	2.15 (6-04)
Vodafone/AirTouch	1.10	NYSE	VOD	12.83	0.81 (3-03)	0.84 (3-04)
S&P Dep. Receipts	1.00	AMEX	SPY	81.79	4.22 (2002)	4.71 (2003)
Total Market VIPERs	1.02	AMEX	VTI	76.75	n/a	
DJIA Diamonds	0.86	AMEX	DIA	76.00	4.88 (2002)	5.60 (2003)
Nasdaq 100 Index	1.67	AMEX	QQQ	20.75	*	

\* **Marketimer** estimates the forty largest companies in the Nasdaq 100 Index are trading at an average p/e ratio of 23.6 times projected 2003 earnings. These forty companies account for 80% of the Nasdaq 100 Index market capitalization.

## ACTIVE/PASSIVE PORTFOLIO

The **Marketimer** Active/Passive portfolio invests for diversification, low tax liability, low expenses and management of risk through long-term market timing. The portfolio remains 65% in stock market cash reserves, 25% in Vanguard Total Stock Market Index, 5% in Vanguard International Growth and 5% in T. Rowe Price or Vanguard European.

## MARKETIMER NO-LOAD MUTUAL FUND MODEL PORTFOLIOS

The **Marketimer** no-load model portfolios are designed to provide investors seeking aggressive, growth and balanced objectives with a strategic approach to investing in no-load funds over the long-term.

Model Portfolio I is designed for investors with *aggressive growth* investment objectives. Such investors seek maximum returns and are willing and able to accept high levels of risk and volatility. Current income is not a factor in this portfolio.

Model Portfolio II is designed for investors with *long-term growth* objectives. Such investors seek to enhance the value of capital over time and assume a reasonable level of diversified market risk. Current income is not an important factor.

Model Portfolio III is designed as a *balanced* portfolio for current investment income along with capital preservation and modest growth. The portfolio is allocated evenly between equities and fixed-income securities. This portfolio is best suited to investors nearing or already enjoying a retirement lifestyle.

### MARKETIMER MODEL PORTFOLIO I

(\$20,000 value on 1-1-88)

<u>Current Holdings</u>	<u>Symbol</u>	<u>%</u>	<u>Beta</u>	<u>Value</u>	<u>9-30-02</u>	<u>% Change</u>
Baron Growth	BGRFX	05	1.00	\$	4,214	
Baron Small Cap.	BSCFX	05	1.05		3,517	
Rowe Price European	PRESX	05	0.69		2,125	
Vanguard Int'l. Growth	VWIGX	05	0.70		1,805	
TIAA/CREF Equity Index	TCEIX	15	1.02		12,136	
Money Market		<u>65</u>	<u>0.00</u>		<u>102,170</u>	
		<u>100%</u>	<u>0.33</u>	\$	<u>125,966</u>	<u>+ 530%</u>

### MARKETIMER MODEL PORTFOLIO II

(\$20,000 value on 1-1-88)

<u>Current Holdings</u>	<u>Symbol</u>	<u>%</u>	<u>Beta</u>	<u>Value</u>	<u>9-30-02</u>	<u>% Change</u>
Gabelli Asset Fund	GABAX	05	0.74	\$	3,365	
Rowe Price European	PRESX	05	0.69		2,371	
Dodge & Cox Stock Fund	DODGX	05	0.60		4,101	
Vanguard Int'l. Growth	VWIGX	05	0.70		1,834	
TIAA/CREF Equity Index	TCEIX	15	1.02		8,606	
Money Market		<u>65</u>	<u>0.00</u>		<u>82,576</u>	
		<u>100%</u>	<u>0.29</u>	\$	<u>102,853</u>	<u>+ 414%</u>

### MARKETIMER MODEL PORTFOLIO III

(\$40,000 value on 3-1-90)

<u>Current Holdings</u>	<u>Symbol</u>	<u>%</u>	<u>Beta</u>	<u>Value</u>	<u>9-30-02</u>	<u>% Change</u>
Vanguard Short-Term Federal	VSGBX	25	0.00	\$	29,388	
Vanguard Ginnie Mae Fund	VFIIX	25	0.00		33,645	
Rowe Price European	PRESX	02.5	0.69		1,844	
Dodge & Cox Stock Fund	DODGX	05	0.60		7,892	
TIAA/CREF Growth & Income	TIGIX	07.5	1.02		6,787	
Vanguard Int'l. Growth	VWIGX	02.5	0.70		1,582	
Money Market		<u>32.5</u>	<u>0.00</u>		<u>39,690</u>	
		<u>100%</u>	<u>0.14</u>	\$	<u>120,828</u>	<u>+ 202%</u>

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### HOW TO SUBSCRIBE TO **BOB BRINKER'S** MARKETIMER

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